National Credit Union Administration
REGION IV

Letter of Understanding and Agreement
By and Between
The National Credit Union Administration
and
Toledo Urban Federal Credit Union

National Credit Union Administration (NCUA) District Examiner Andrea Landro-Pike has conducted on-site contacts each month during 1999 including a Supervisory Examination as of March 31, 1999, and a Follow-Up Examination as of August 31, 1999. As cited in the written reports provided to the credit union this year, the officials have failed to take adequate action to reverse the continued and accelerating decline in the financial condition of the credit union. If the officials do not take immediate action to reverse the negative trends, the continued operations of Toledo Urban Federal Credit Union will be jeopardized. For that reason, we are asking you to join with us in formal recognition of the credit union's situation. By doing so, the board of directors acknowledges that serious areas of concern exist, and agrees to take the necessary action to restore the credit union to a safe and sound condition. This agreement will benefit your credit union, its members and creditors, and the National Credit Union Share Insurance Fund (NCUSIF).

The adverse conditions and trends are as follows:

I. **Capital:** The credit union has a substantial negative net capital position of $105,382, or -3.7 percent of assets. Net capital has significantly declined from $11,115, or .38 percent of assets, as of December 31, 1998.

II. **Earnings:** A massive net operating loss of $186,771, or 7.8 percent of average assets, has been sustained for the 10 months ending October 31, 1999. This operating loss is almost equal to the total operating losses of $189,852 for 1996, 1997, and 1998.

III. **Lending:** Loan quality concerns noted include:

A. Charge-off loans, net of recoveries, are excessive at $119,906, or 7.4 percent of average loans, for the 10 months ending October 31, 1999. Charge-offs have substantially increased in 1999 compared to 1998 when $41,414, or 2.1 percent of average loans, were charged off.

B. Delinquency is high at $70,248, or 4.1 percent of loans, as of October 31, 1999. While delinquency has decreased from $204,605, or 9.4 percent as of December 31, 1998, a vast majority of the delinquency decrease is the result of charging off delinquent loans.

C. The loan portfolio still contains a high percentage of higher risk loans which are responsible for the excessive amount of charge-offs. While the quality of loans granted has improved somewhat in the last 18 months, too many higher risk loans are still being granted.

4225 Naperville Road • Suite 125 • Lisle, Illinois 60532 • 630-955-4100 • 630-955-4120 Fax

Dividend Restrictions: The credit union's low capital position and operating losses have necessitated dividend approval letters pursuant to Section 208 of the Federal Credit Union Act from this office. In making these approvals, we were assured by the credit union's board of directors that positive action would be taken to improve the operating and financial condition of your credit union. Appropriate progress has not been achieved.

Management and Officials:

A. The manager has not properly reconciled all General Ledger accounts or properly handled negative shares accounts. This has resulted in unnecessary accounting write-offs of at least $20,000 for the 10 months ending October 31, 1999. An additional $12,945 out-of-balance condition is still being researched and is a probable accounting write-off. In addition, an outside accountant was hired to reconcile the Corporate One Account and various other accounts costing the credit union at least $13,000 through October 1999.

B. Weak internal controls made the embezzlement of funds by employees easier to perpetrate and have necessitated an expensive fraud audit.

C. The Board of Directors has failed to take adequate action to return the credit union to a positive net equity position, achieve a positive profit level, and correct the other serious areas of concern. There has been a Letter Of Understanding and Agreement in place since June 16, 1996. There have been violations of the agreement over that period of time and currently there are five major terms that are not being adhered to.

In order to resolve the conditions and reverse the trends noted above, the following actions and schedules for accomplishment have been mutually agreed upon by all parties to this agreement.

Agreements and Time Frames

I. Capital

A. The board of directors will obtain donated equity as follows:

1. At least $25,000 will be obtained by December 31, 1999, to reduce the net equity deficit of $105,382 which exists as of October 31, 1999;
2. At least an additional $40,000 in donated equity will be obtained by March 31, 2000;
3. Additional donations necessary to completely eliminate the negative net capital position (approximately $41,000) will be obtained by June 30, 2000; and
4. Continued donations to maintain a positive net equity position and attain the net capital ratios as stated below will be obtained as necessary, which may require increasing the amounts stated above in items A2 and A3.

B. The credit union will achieve the following net capital ratios. The net capital ratio is defined as Regular Reserves and Undivided Earnings and Donated Equity divided by total assets.

- 0.15 percent by July 31, 2000.
- 0.45 percent by September 30, 2000.
- 0.90 percent by December 31, 2000.

II. Earnings

A. The board of directors will ensure the following earnings levels are achieved <u>before Provision for Loan Losses expense and cost of funds</u>. The stated earnings percentages are annualized as a percent of average assets.

- 2.40 percent of average assets per month during the first six months of 2000.
- 2.80 percent of average assets per month during the last six months of 2000.

B. The board of directors will ensure the following earnings levels are achieved <u>before Provision for Loan Losses expense</u>. The stated earnings percentages are annualized as a percent of average assets.

- 0.75 percent of average assets per month during the first six months of 2000.
- 1.25 percent of average assets per month during the last six months of 2000.

C. The board of directors will ensure the following net income levels are achieved. The stated percentages are annualized as a percent of average assets.

- 0.00 percent of average assets per month for the first six months of 2000.
- 0.50 percent of average assets per month for the last six months of 2000.

D. The board of directors will ensure that the Allowance for Loan Losses account is fully funded for known and probable loan losses plus the amount for the historical loan loss reserve prior to closing the books at the end of each month.

III. Lending

A. Delinquency in relation to total loans will be reduced to 3.5 percent by January 31, 2000, and will not exceed this level any month thereafter.

B. Net charge-offs (annualized) in relation to average loans will be limited to no more than 1.5 percent during each calendar quarter of 2000 and thereafter.

C. The board of directors will ensure that collections are performed in compliance with the Collection Policy dated August 1999, or subsequent collection policies which must be as restrictive as the policy approved in August.

D. The board of directors will ensure that the following criteria are heeded when loans are granted in an effort to reduce the amount of loans that are charged off:

1. Loans will not be granted to members with a debt ratio exceeding 40 percent of gross income;
2. Loans will not be granted to members with credit reports disclosing unpaid judgments or collection accounts (except for medical collections less than $200), debts which are currently delinquent, bankruptcy within the last three years, and charge-offs greater than $100;
3. A down payment of at least 20 percent on secured loans will be required when the member's debt ratio is between 30 and 40 percent of gross income or when some previous derogatory credit history exists (the derogatory credit must have been paid prior to obtaining the credit report);
4. The secured (non-real estate) loan limit is $25,000 with a maximum term of five years;
5. The aggregate unsecured loan limit per borrower is $2,500 with a maximum term of three years;
6. The maximum outstanding credit to any member will not exceed $27,500; and
7. Given that *all* situations cannot be covered in a loan policy, the board will ensure that prudent lending practices will be followed in general.

E. The Supervisory Committee will perform (or cause to be performed) a monthly quality control review of recently granted loans to ensure that the loans are granted consistent with the loan policy and sound lending practices.

IV. **Dividend Restrictions:** Terms and conditions of the November 19, 1999, letter from this office will be adhered to. This letter necessitates **that the credit union must immediately cease paying dividends on any share accounts, including share certificates, until the equity deficit is completely eliminated and the cost of the dividends can be paid from current earnings.**

V. **Management and Officials**

A. **Accounting**

1. The supervisory committee will ensure that management reconciles all General Ledger accounts by the 25th of each month.

2. The supervisory committee will ensure that no item on the General Ledger reconciliations are outstanding for more than 90 days.

3. All items which must be written off will be presented to the board for approval. The title of the General Ledger account, the amount to be written off, and the reason for the write-off will be detailed in the board minutes.

4. The board of directors will hold the manager accountable for minimizing losses due to accounting write-offs.

5. The supervisory committee will ensure that the 1999 annual audit is completed no later than March 31, 2000.

B. **Internal Controls and Related Audits**

The board of directors will ensure that proper internal controls are in place for all areas of operations.

2. The board of directors will contract for an audit of the credit union's compliance with the Bank Secrecy Act (BSA). This audit will be performed by a qualified firm/individual and must include a review of member accounts. An audit report will provide recommendations to address violations, if any. The BSA audit will be completed and the written report forwarded to the NCUA examiner by February 15, 2000.

3. The board of directors will obtain a fraud audit from a firm with experience in conducting this type of audit. The fraud audit will include a 100 percent verification of member accounts as of December 31, 1999. The fraud audit will be completed and the written report forwarded to the NCUA district examiner by March 15, 2000.

4. The board of directors will use the results of the fraud audit to file a bond claim with the bonding company by March 20, 2000, if applicable.

5. By December 20, 1999, the board of directors will request from the bonding company an extension for filing the bond claim, if it is determined that a claim cannot be filed within 180 days after the discovery of loss.

C. **Operating Management**

1. The board of directors will establish written performance standards for the manager. The standards will include, but not be limited to, weaknesses cited in the last Follow-Up Examination Report.

2. The board of directors will complete a written performance appraisal of the manager each quarter. The board will submit copies of the quarterly evaluations to the NCUA district examiner within 20 days of the end of the quarter. The board minutes will reflect approval of the performance appraisal.

3. The board of directors will forward the financial and statistical reports and a copy of the board minutes to the NCUA district examiner by the 20th of the following month.

The officials may request changes to this agreement after it has been signed and in effect for 60 days. The request must be in writing to the NCUA Regional Director and must contain adequate support and explanations as to why a change is warranted.

The management of your credit union should understand how seriously NCUA takes its responsibility to ensure that the credit union system remains safe, strong, and secure. We want to work with you to identify and resolve problems to avoid more serious consequences. However, if conditions worsen, or the "agreed upon actions" are not finalized within the stated "time frames", NCUA may take appropriate action to remove any official or management personnel, or use other available administrative remedies, including merger, conservatorship, liquidation of the credit union, or civil money penalties.

Therefore, the officials indicate that they understand and agree with the contents of this Agreement by affixing their signatures to this letter. This Agreement may be modified only by the mutual consent of the board of directors and the NCUA regional director.

This Letter of Understanding and Agreement will be published.

FOR THE TOLEDO URBAN FEDERAL CREDIT UNION

Frances L Smith — Dec. 20, 1999
Chairman of the Board of Directors — **Date**

12-21-1999
~~Treasurer~~ Security — **Date**

12/30/99
Secretary — **Date**

12-20-1999
Manager/President — **Date**

FOR THE NATIONAL CREDIT UNION ADMINISTRATION

12/27/99
Examiner — **Date**

12/29/99
Supervisory Examiner — **Date**

1/5/2000
Regional Director — **Date**